United States Court of Appeals

for the Second Circuit

PETITION FOR REHEARING

75-7051

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FOR THE SECOND CIRCUIT

NO. 75-7051

FIRST NATIONAL BANK OF HOLLYWOOD,
DOROTHY BUCHMAN and SANDER BUCHMAN,
as Executors of SAMUEL BUCHMAN,
deceased,

Plaintiffs-Appellees,

v.

AMERICAN FOAM RUBBER CORP., MILTON R.
ACKMAN, as Trustee of AMERICAN FOAM
RUBBER CORP., Bankrupt,

Defendants,

MARIE LOUISE deMONTMOLLIN, ALEXANDER F. PATHY and SUZANNE M. PATHY,

Defendants-Appellants.

On Appeal from the United States District Court for the Southern District of New York

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DEFENDANTS-APPELLANTS' PETITION FOR REHEARING

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Defendants-Appellants.

PETITION FOR REHEARING

Defendants-Appellants Marie Louise deMontmollin, Alexander F. Pathy and Suzanne M. Pathy ("appellants"), petition this Court for a rehearing of that portion of this Court's decision of February 5, 1976 ("the decision") which affirmed the District Court's award of damages in the amount of $15,000 to the plaintiff-appellees (the "appellees").

This petition is based upon the ground that the Court, in affirming the award of $15,000 in damages for the breach of the subordination agreement occasioned by the "Loan Transaction," overlooked the question of the appropriate measure of damages for that breach and, moreover, failed to analyze and determine the amount of damages, if any, suffered by the appellees. The decision held that the District Court properly determined that the Loan Transaction constituted a breach of the agreement and, without any analysis or discussion of the question of damages, affirmed its award of damages.

ARGUMENT

I.

IN RENDERING ITS DECISION RESPECTING THE LOAN TRANSACTION, THIS COURT OVERLOOKED THE QUESTION OF THE APPROPRIATE MEASURE OF DAMAGES FOR THE BREACH OF THE SUBORDINATION AGREEMENT.

The Loan Transaction

The Loan Transaction was one by which appellant Marie Louise deMontmollin ("Mrs. deMontmollin") surrendered to Burlington Holding Corp. ("Burlington") a $15,000 debenture upon its maturity on April 1, 1960. In return for the surrendered debenture, Mrs. deMontmollin simultaneously received a credit on Burlington's books which was, in turn, "loaned" to American Foam Rubber Corp. ("AFR"), its parent corporation, by Mrs. deMontmollin. In return for the loan, Mrs. deMontmollin received a $15,000 promissory note of AFR payable, with interest, in the amount of 6%, on December 30, 1960. That note was never paid to Mrs. deMontmollin.

The appellees contended that the Loan Transaction brought about the discharge of the Burlington debenture and that said discharge constituted "payment" within the meaning of the subordination agreement (the "agreement") entered into between appellees' testator and the appellants. The District Court held that Mrs. deMontmollin received "payment" on the debenture in the amount of $15,000 when she received the credit and made the loan to AFR (239a-240a). This Court,

however, held that the note received from AFR constituted payment and, without any apparent recognition or consideration of the difference between its finding and that of the District Court, affirmed the award of $15,000 in damages (p. 1787).

The Appellees' Rights Are Governed Solely By the Terms of the Agreement.

In its discussion of the Exchange Transaction, this Court held that the rights of the parties to a subordination agreement are governed solely by the terms of the agreement (pp. 1782-1783). In its discussion of the Loan Transaction, the Court specifically held that the Loan Transaction effected "a payment of the debenture within the meaning of the subordination agreement." (p. 1787) (Emphasis supplied).

More particularly, in affirming the District Court's award of damages, this Court held that the amount of damages to which appellees were entitled was governed by the "specific provisions of the subordination agreement."

> "Plaintiffs were entitled to recover the amount of this payment by virtue of the specific provisions of the subordination agreement." (p. 1787)(Emphasis supplied).

The language employed in the decision, to wit, "the amount of this payment" is virtually the same as the language of the agreement which sets forth the remedy for its breach.

That provision, set forth at pages 1777-1778 of the decision provides:

> "If for any reason, either corporation shall pay interest on principal on said debentures to any of the Buyers, or to any person deriving title to the debentures of said corporation from any of the Buyers, and said (payment) shall be made without first satisfying the priority to which the holder or holders of Samuel Buchman's debentures are entitled by reason of the foregoing provisions, the amount of amounts of the payment so made to the Buyer (or to the person deriving title from her or him) shall be promptly paid by such Buyer to said holder or holders of Samuel Buchman's debenture". (Emphasis supplied.)

This provision must, therefore, control any award of damages to the appellees.

Appellants do not, in this petition, challenge the Court's interpretation of the agreement and its determination of the rights of appellees upon the receipt of payment. Moreover, for the purposes of this petition, the Court's holding that Mrs. deMontmollin's receipt of the AFR note constituted payment on the debenture is assumed to be correct. What is challenged herein is the Court's acceptance of the damages awarded by the District Court without any consideration of the amount of the payment received by Mrs. deMontmollin.

This Court held that the Burlington debentures were "paid" when Mrs. deMontmollin received AFR's note. It based this holding upon the principle that, "where a creditor takes the bill, note or check of a third party

instead of insisting upon performance, a reasonable inference may sometimes be drawn that the primary obligation has been paid and discharged." However, this Court affirmed the District Court's assessment of the "amount" of that payment, without recognizing the fact that the District Court's assessment was based upon "payment" different from the note. The District Court measured the "amount or amounts of the payment so made to [deMontmollin]" by the amount of the credit noted on the books of Burlington and determined that that amount was $15,000. However, because this Court held that it was the note, which constituted "payment" within the meaning of the subordination agreement, the "amount" of the payment must be measured by the amount or value of the note, not the credit or the debenture for which it was exchanged.

The question of the "amount" represented by the note was never considered by this Court. Although it is an elementary principal of contract law that the plaintiff in an action for breach of contract bears the burden of presenting proof upon which the amount of his damages can be based, Haughey v. Belmont Quadrangle D Corp., 284 N.Y. 136, 142, 29 N.E.2d 649 (1940), appellees never produced any evidence upon which the "amount" of the "payment" could be measured. It is respectfully submitted that, absent such evidence, no determination can be made by this Court, nor by the District Court, respecting the amount of damages, if

any to be awarded.

Appellants further submit that there are important differences between the credit on the Burlington books and the note received from AFR, which differences are sufficient to evidence a difference in their respective values. First, as the District Court found (237a, n. 55), Mrs. deMontmollin could have drawn against the credit immediately upon its entry upon Burlington's books. Thus, according to the District Court, that "payment" was immediately reduceable to an easily ascertainable "amount" of cash (Ibid.). But the note did not represent an immediately available source of funds. It was not payable until December 30, 1960 (237a, n. 56). Certainly the difference in value between an immediately available source of funds and one whose availability is postponed must be considered.

It is respectfully submitted that the note must be valued in light of the circumstances surrounding its execution and delivery to Mrs. deMontmollin, with particular consideration given to the commercial practicalities and realities surrounding its delivery. Cf. Bar L. Ranch, Inc. v. Phinney, 426 F.2d 995 (5th Cir. 1970). The uncontroverted testimony presented to the District Court demonstrates that the facts and circumstances surrounding the Loan Transaction evidence the fact that the note, if it was worth anything, was worth far less than its face value of $15,000. The purpose of the entire Loan Transaction was to increase the capital of AFR in order to obtain

more favorable financing for the company (159a, 160a, 161a, 183a, 184a). It is uncontrovertable that, when Mrs. deMontmollin received the note, she accepted it without any expectation of repayment or any belief that it was worth $15,000 (183a, 184a). This lack of any expectation of payment or value is further evidenced by the fact that Mrs. deMontmollin did not present the note to AFR when it was due (184a) and that AFR's indebtedness to her was still carried on the books of AFR subsequent to December 30, 1960 (Exhibit 2).

In fact, no claim for payment on the note was ever made by Mrs. deMontmollin (184a). The note was assigned to an attorney and presented as a claim in bankruptcy against AFR (239a, n. 60). No liquidation dividend was received by Mrs. deMontmollin or her assignee prior to the payment of all of Buchman's debentures. Thus, it is clear that the receipt of the note did not in any way work to the detriment of Buchman, nor did it bring about any diminution in his interest in receiving payment on his debentures.

Thus, even though the Loan Transaction may have resulted in the "payment" of Mrs. deMontmollin's debenture prior to those held by Buchman, the "amount or amounts of the payment" was never shown to have been, nor can it ever be shown to have been $15,000. Indeed, Mrs. deMontmollin did not receive a penny and, correspondingly, appellees were not prejudiced at all by her "payment."

The question of the proper valuation of a promissory note frequently arises in connection with Internal Revenue proceedings in which the taxpaper challenges the Internal Revenue Service's valuation of the gross estate of a decedent under Internal Revenue Code § 2031, 26 U.S.C. § 2031. The rule under § 2031, set forth in Regulation § 20.2031-4 is that, while the fair market value of notes is presumed to be the unpaid amount, the presumption may be overcome by showing that the note is worth less than the unpaid amount or that the note is uncollectable in whole or in part for any reason, including the insolvency of the party liable thereon. While there is no equivalent presumption applicable here, the factors respecting valuation considered in the tax cases are relevant here.

In Mullikin v. Magruder, 55 F.Supp. 895 (D.Md. 1944) an action to recover the alleged overpayment of estate taxes, the District Court held that a note held by a decedent at the time of his death was worthless because the maker had no assets with which to pay the note. All of his assets were subject to claims having priority over the decedent's claim. Moreover, the Court noted the fact that the decedent had not received any payment up to the time of his death, the date upon which the valuation was made.

The instant case is somewhat similar. The undisputed evidence presented at the trial demonstrated the fact that AFR was also unable to pay Mrs. deMontmollin $15,000 on the note. As the testimony of Alexander Pathy reveals (128a-

132a), AFR was in poor financial condition in 1960 and was having difficulty in meeting numerous financial obligations. Moreover, these obligations, including the debt to Buchman, had priority over the unsecured debt to Mrs. deMontmollin represented by the note by virtue of the subordination agreement and AFR's financing agreements with Walter E. Heller & Co. Thus, the evidence is clear that the note was, for all practical purposes, uncollectable when delivered to deMontmollin and was, therefore, worthless.*

The fair market value of a note must be measured by "what a willing buyer would pay a willing seller when neither is under any compulsion and both are reasonably informed as to all relevant facts." Bar L Ranch, Inc. v. Phinney, supra at 999. It is submitted that, in the case at bar, the market value of this note was zero. Any reasonably informed buyer would have realized that the prospects for recovery on the note were, at best, slim.

This Court's assumption that the note's value was equal to the face value of $15,000 is contrary to the law and at variance with the uncontested testimony adduced at trial. There was no discussion or analysis of the "amount" of either the payment in the decision or the District Court opinion. It is respectfully submitted that this Court's failure to consider the note's actual value is a clear ground for the granting of this petition.

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* The poor financial condition of AFR both at the time of the delivery of the note and its maturity date of December 30, 1960, is further evidenced by the filing of a petition in bankruptcy by AFR in February of 1961.

CONCLUSION

For the reasons set forth herein, the appellants' petition for a rehearing should be granted.

DATED: New York, New York
March 4, 1976

Respectfully submitted,

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Of Counsel

STATE OF NEW YORK)
ss:
COUNTY OF NEW YORK)

MIRIAM A. GANDIA, being duly sworn, deposes and says:

Deponent is not a party to the action, is over 18 years of age and resides at Staten Island, New York.

On March 4, 1976, deponent served two copies of the within Petition for Rehearing upon Joseph Heller and Jacob E. Heller, attorneys for plaintiffs-appellees in this action, at 51 Chambers Street, New York, New York 10007, the address designated by said attorneys for that purpose by deposing true copies of same enclosed in a postpaid properly addressed wrapper, in an official depository under the exclusive care and custody of the United States Postal Service within the State of New York.

Miriam A. Gandia

MIRIAM A. GANDIA

Sworn to before me this
4th day of March, 1976.

Barbara Holtz

NOTARY PUBLIC

BARBARA HOLTZ
Notary Public, State of New York
No. 31-4620736
Qualified in New York County
Commission Expires March 30, 1977